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The CFPB Must Collect Small Business Lending Data from All Financial Institutions to Further Fair Lending Objectives

Paul Calem and Paige Paridon | June 21, 2021

The Consumer Financial Protection Bureau (CFPB) currently is in the process of formulating a rule to implement section 1071 of the Dodd Frank Act, which mandates the collection of data on applications for loans by privately-owned (in general, small) businesses, particularly on the demographic characteristics of the business owners.[1] This collection is intended "to facilitate the enforcement of fair lending laws and enable communities, governmental entities and creditors to identify business and community development needs and opportunities of women-owned, minority-owned and small businesses."[2]

The CFPB rule will determine what categories of lenders will be required to submit section 1071 data, and what specific information will be collected. Results from recent Small Business Credit Surveys (SBCS) conducted by the Federal Reserve have shown that nonbanks are a major source of credit for small businesses, particularly for minority-owned firms and firms of relatively higher credit risk. The SBCS also has consistently shown that most applicants to online lenders and finance companies are often dissatisfied with the high cost of the loans and unfavorable repayment terms. Other analyses have shown a recent spike in FinTech consumer complaints filed with the CFPB more broadly.[3] Thus, in order to achieve the statutory purposes of section 1071, as well as the CFPB's commitment to fair lending enforcement,[4] the CFPB must collect section 1071 lending data from *all* financial institutions operating in that market, and not just banks. Further, any non-public data collections by the CFPB undertaken in a supervisory context for assessing compliance with fair lending or consumer protection rules should encompass not just banks but also nonbank lenders, including FinTech companies, in order to ensure fair lending compliance in the market for small business loans.

Section 1071 data will in large part be made available to the public and is thus an important step towards greater transparency in the small business lending market. At present, there is just one major regulatory collection of

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[1] The issuance of a Proposed Rule under section 1071 is subject to a Stipulated Settlement Agreement and Order between the California Reinvestment Coalition (and other parties) and the CFPB. In the Bureau's latest Status Report of May 24, 2021, the Bureau stated that "the parties have met and conferred regarding an appropriate deadline for issuance of the Section 1071" rulemaking but have not yet agreed on a deadline. *See* Defendants' Fifth Status Report (U.S. Dist. Ct. ND Cal.). In the Biden Administration's recently-published Unified Agenda of Regulatory and Deregulatory Actions (Agenda), the Bureau provided that it anticipates issuing an NPR under section 1071 in September of this year. *See* https://www.reginfo.gov/public/do/eAgendaMain

[2] *See* the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, section 1071, 124 Stat. 1376, 2056 (2010) (section 704B of ECOA was added by section 1071 of the Dodd-Frank Act) (codified at 15 U.S.C. 1691c-2).

[3] *See* Claire Williams, "The Number of Fintech Consumer Complaints Filed to the CFPB Exploded in the Beginning of 2021," Morning Consult (April 26, 2021) (quoting a legal practitioner: "'Practically, one of the reasons why these products are getting more complaints is that digitally native products are advertising that they function like a bank and that they have all the same consumer protections' . . . . 'If they aren't living up to this promise, that's where the complaints are coming from.'").

[4] *See, e.g.*, the Bureau's press release in connection with its 2020 Fair Lending Report to Congress, *available at*: Protecting consumers through a pandemic: 2020 Fair Lending Report to Congress | Consumer Financial Protection Bureau (consumerfinance.gov) ("In 2021 and beyond, the Bureau will place greater emphasis on fair lending and efforts to address racial equity for underserved communities, and will report on those efforts in 2022.").

lending data at the application and loan level that is made substantially available to the public: Home Mortgage Disclosure Act (HMDA) data.[5] As its name suggests, these are data solely for mortgages on residential homes. HMDA data are used in part for fair lending purposes and include the applicant's race or ethnicity and gender and whether an application was approved. HMDA data are collected from all mortgage lenders – bank and nonbank – meeting minimum size thresholds, so that HMDA-based fair lending screens can be applied across all lender categories.

In the remaining discussion, we first review the actions the CFPB has taken in preparing to issue a proposal for the section 1071 collection. We then discuss the history and evolution of HMDA and its usefulness as a model for the data collection that should be undertaken under section 1071. Finally, we elaborate on the significant role of FinTech and other nonbank lenders in the small business loan market. The latter discussion underscores the importance of requiring FinTechs and other nonbanks to submit section 1071 data, and the importance of treating banks and nonbanks comparably in regard to information gathering efforts by the CFPB through its other authorities.

THE CFPB'S PLANNED DATA COLLECTION TO IMPLEMENT SECTION 1071

Section 1071 of the Dodd-Frank Act requires "financial institutions" (FIs) to compile, maintain, and submit to the Bureau certain data on applications for credit for women-owned, minority-owned, and small businesses "to facilitate enforcement of fair lending laws and enable" the identification of "business and community development needs and opportunities of women-owned, minority-owned, and small businesses."[6]

Under section 1071, FIs are required to compile, maintain and submit the following data: (1) whether the applicant is a women-owned, minority-owned and/or small business, (2) application/loan number, (3) application date, (4) loan/credit type, (5) loan/credit purpose, (6) credit amount/limit applied for, (7) credit amount/limit approved, (8) type of action taken, (9) action taken date, (10) census tract (principal place of business), (11) gross annual revenue and (12) race, sex and ethnicity of the applicant's principal owners.[7]

Section 1071 also requires FIs to collect and report "any additional data that the Bureau determines would aid in fulfilling the purposes of [section 1071]."[8] The Bureau is considering requiring the reporting of the following "discretionary data points": pricing, time in business, NAICS code and number of employees.[9]

The CFPB has explained that these data could be helpful in the assessment of fair lending performance and for assessing community development needs.[10] In addition, these data may prove helpful for identifying opportunities to expand access to credit to minority- and female-owned small businesses and new product development opportunities.[11]

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[5] In addition, federally regulated depository institutions annually report data on the geographic distribution of their small business and community development lending, again subject to minimum size thresholds (Community Reinvestment Act data). These data are useful for assessing CRA performance and are made substantially available to the public. However, these data are not suitable for assessment of fair lending compliance as they do not provide information on loan application decisions. Since non-depository institutions are not subject to the CRA, nonbank small business lenders do not submit CRA data.

[6] 15 U.S. Code § 1691c–2

[7] 15 U.S. Code § 1691c–2(e)(2).

[8] 15 U.S. Code § 1691c–2(e)(2)(H).

[9] *See* Small Business Advisory Review Panel for Consumer Financial Protection Bureau Small Business Lending Data Collection Rulemaking: Outline of Proposals Under Consideration and Alternatives Considered, 33-35 (September 15, 2020), available here.

[10] *Id.*

[11] *Id.*

The CFPB has rulemaking authority over this provision of the DFA. [12] While the agency has yet to issue a proposed rule, it has taken steps towards formulating a proposal (see Appendix 1 for an overview). Importantly, the Bureau has indicated that it is considering a general definition of "financial institution" that is consistent with section 1071(h)(1), which defines the term "financial institution" as "any partnership, company, corporation, association (incorporated or unincorporated), trust, estate, cooperative organization, or other entity that engages in any financial activity."[13]

Under this type of broad definition, the rule's data collection and reporting requirements would apply to a variety of entities that engage in small business lending. Covered institutions would include not only DIs, but also "online lenders/platform lenders; CDFIs (both DIs and non-DIs); lenders involved in equipment and vehicle financing (captive financing companies and independent financing companies); commercial finance companies; governmental lending entities; and non-profit, non-DI lenders."[14]

COMPARISON TO AND OVERVIEW OF HMDA

HMDA data, submitted annually in early spring by mortgage lending institutions, provide information on each home purchase and refinance mortgage application from the preceding year, and have proven to be a highly effective resource for monitoring lenders' fair lending performance. [15] HMDA was enacted in 1975 to address "redlining" and originally was somewhat limited in scope—confined to depository institutions submitting data on the geographic distribution of the residential mortgages that they originated or purchased.[16] These data were used by regulators to counter potential discrimination in lending based on neighborhood demographics and monitor CRA compliance, and by researchers interested in examining patterns of mortgage lending across neighborhoods.[17] Over time, Congress and the regulators expanded the data collection requirements to better meet the purposes of HMDA.

The 1989 Financial Institutions Reform, Recovery and Enforcement Act amended HMDA to make it more broadly applicable for fair lending purposes. The data items required to be collected under section 1071 are similar to those mandated for HMDA reporting by FIRREA.

FIRREA expanded the scope of the data collection beyond originated mortgages, to include reporting of information on each individual loan application.[18] Specifically, HMDA respondents were required to report the disposition of each loan application (whether approved, denied or withdrawn), the applicant's income, the gender and the racial or ethnic classification of the applicant (and of the co-applicant, if applicable), the Census tract

[12] 15 U.S. Code § 1691c–2(g).
[13] See the final report of the CFPB's Small Business Review Panel, page 7.
[14] The Bureau also noted that "several other key definitions will determine whether or not an FI has a duty to collect and report data on credit applications under section 1071. In addition to satisfying this general definition of "financial institution," an FI must receive applications for covered lending products for small businesses . . . to trigger a duty to collect and report data on credit transactions under section 1071." *See id*.
[15] *See*, *generally*, "A Guide to HMDA Reporting Getting It Right!" (Effective Jan. 1, 2020), available here.
[16] *See*, e.g., Richard D. Marisco, "Looking Back and Looking Ahead as The Home Mortgage Disclosure Act Turns Thirty-Five: The Role of Public Disclosure of Lending Data in a Time of Financial Crisis, BU School of Law Journal of Banking and Financial Law, 29 Ann. Rev. Banking & Fin. L. 205, 209 (2009) ("Congress' intent in passing HMDA was to use the power of public disclosure to eliminate redlining in low-income, urban and predominantly minority neighborhoods. HMDA's initial provisions were limited, covering only banks and their majority-owned mortgage lenders and requiring them to disclose only the location of their home mortgage loans.")
[17] HMDA originally was implemented through the Federal Reserve Board's regulation C, which recognized that HMDA "data that can be used to assist: (i) in determining whether financial institutions are serving the housing needs of their communities; (ii) public officials in distributing public-sector investments so as to attract private investment to areas where it is needed; and (iii) in identifying possible discriminatory lending patterns." *See* FFIEC, HMDA: Background and Purpose, available at: Background and Purpose of HMDA (ffiec.gov). Often, such research was motivated by concerns that neighborhoods with predominantly minority populations were being arbitrarily excluded by some mortgage lenders, a phenomenon referred to as "redlining." *See, e.g.*, Robert B. Avery, "Making Judgments About Mortgage Lending Patterns," Federal Reserve Bank of Cleveland *Economic Commentary*, December 15, 1989, for a brief discussion of this literature.
[18] *See* Federal Financial Institutions Examination Council, "History of HMDA," available at: History of HMDA (ffiec.gov).

location of the subject property, and various other fields.[19] In addition, the FIRREA amendments broadened the coverage of HMDA to include mortgage lenders not affiliated with depository institutions or bank holding companies, making HMDA data usable for fair lending assessments of both banks and nonbanks.[20]

The Dodd-Frank Act amended HMDA once again, to require reporting of additional data items. The DFA also transferred HMDA rulemaking authority from the Federal Reserve Board to the CFPB. See Appendix 2 for further details on these changes to HMDA reporting after 2000.

Since 1989, when HMDA reporting was expanded to include information on the disposition of loan applications, the banking regulatory agencies have utilized HMDA data for developing preliminary assessments of banks' fair lending performance, helping the regulators to prioritize examination resources. As described by the Federal Financial Institutions Examination Council, "The HMDA data are used by industry, consumer groups, regulators, and others to assess potential fair lending risks and for other purposes."[21] Also, these data have been used in numerous research studies examining market wide disparities in approval rates on loan applications; use of high-cost loans; and other market performance outcomes by applicant race and ethnicity.[22]

Clearly, as recognized by Congress and regulators over time as they expanded the required data collection under HMDA, HMDA data would be far less useful for assessing market-wide trends, including fair lending compliance, had reporting been limited to depository institutions. Pre-2008, nonbank lenders dominated the high-cost, subprime mortgage market and originated close to 50 percent of government-insured (FHA and VA) mortgages.[23] After declining during the 2008-2011 mortgage crisis period, nonbanks' share of the government-insured market nonbanks has trended sharply upwards, exceeding 90 percent as of January 2021 according to the Urban institute. Moreover, since 2016, nonbank lenders have been originating the majority of conventional conforming mortgages.

Although to a lesser degree than in residential mortgage lending, nonbank lenders have a significant share of the small business loan market, and they disproportionately serve minority-owned small businesses in that market, as explained in greater detail below. Thus, the fair lending performance of the small business lending market can be adequately monitored, and the credit and business development needs of small firms can be reliably assessed, only if, as with HMDA reporting, nonbanks are included alongside banks. The section 1071 data collection will be far less useful for these purposes if reporting is limited to depository institutions.

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[19] *Id.* Other reported data items are the loan amount; loan type (conventional, FHA, VA, or other government-insured) and purpose (purchase or refinance); property type (one-to-four family or multi-family); occupancy status (owner-occupied, second home, or investor property); and whether an originated loan was sold prior to year-end and if so, the purchaser type.

[20] *See* FFIEC "History of HMDA." In 1992, the Federal Reserve Board adopted a standard that further expanded coverage to independent mortgage lenders, after receiving authority from Congress in 1991 via the Federal Deposit Insurance Corporation Improvement Act to apply comparable exemption standards for DIs and non-Dis. Further details on the history of HMDA reporting can be found here. HMDA filers include all commercial banks, savings and loan institutions, credit unions, and mortgage companies that meet minimum asset size thresholds and have a branch in a metropolitan area. For details, see the Federal Financial Institutions Examination Council guidelines on HMDA reporting.

[21] For an overview of the original, HMDA-based fair lending screening process utilized by the Federal Reserve System, see Robert B. Avery, Patricia E. Beeson, and Paul S. Calem, "Using HMDA Data as a Regulatory Screen for Fair Lending Compliance," *Journal of Financial Services Research* 11, pp. 9-42, 1997. HMDA data are also used by the Federal Housing Finance Agency in evaluating the performance of Fannie Mae and Freddie Mac in meeting their single-family housing goals.

[22] See, for example, the various references to studies using HMDA data in Marsha J. Courchane and Stephen L. Ross, "Evidence and Actions on Mortgage Market Disparities: Research, Fair Lending Enforcement, and Consumer Protection," Working Paper 2018-052, Human Capital and Economic Opportunity Working Paper Series, University of Chicago, 2018. The latter study also notes (page 13) that the expansion of HMDA data in 2004 to include identification of high-cost loans "potentially facilitated enforcement actions by non-federal entities. Several state attorneys general began analyzing HMDA data for racial differences" in reliance on high-cost mortgages.

[23] See Paul S. Calem, Lauren Lambie-Hanson, and Susan M. Wachter, "Is the Community Reinvestment Act Still Relevant to Mortgage Lending?," *Housing Policy Debate* 30 (5), pp. 1-15, 2020.

SMALL BUSINESS LENDING BY NONBANKS: EVIDENCE FROM THE SBCS

The crucial role of nonbank lenders as providers of small business credit is demonstrated by findings from the SBCS, the Federal Reserve's annual survey of firms with fewer than 500 employees that gathers information about small business performance, financing needs and choices, and borrowing experiences.[24] According to the Fed's survey those small businesses account for nearly 50 percent of the private-sector workforce and are "vital to the fabric of local communities."

Figures 1 through 3 below are reproduced from the Federal Reserve's *2020 Report on Employer Firms*, which summarizes findings from the 2019 SBCS. These findings demonstrate that nonbank lenders are an important source of credit for small businesses in the United States, and especially for minority-owned businesses, underscoring the need for a broad definition of FIs for the purpose of section 1071.

Figure 1 shows percent of survey respondents that report having applied for a loan, line of credit or cash advance in the previous 12 months by type of lender, with firms separated into two credit quality cohorts (low versus medium or high credit risk.) Note that some respondents applied to more than one type of lender, as reflected in the total percentage of firms applying for credit across all types of lenders exceeding 100 percent within each risk cohort.

Among firms with high credit ratings, banks were the preferred source of credit; for every firm that applied through an online lender, two applied to a large bank and two applied to a small bank. Even within this cohort, nonbanks served as an important source of credit, with more than 20 percent of these firms applying to online lenders. By contrast, for small business applicants with medium or low credit ratings, nonbanks were a more important source of credit. More than half of them applied to an online lender and 20 percent to a finance company, compared to 34 percent applying to a large bank and 32 percent to a small bank.

[24] The SBCS uses a convenience sample of establishments, whereby businesses are contacted by email through a diverse set of advocacy organizations or trade groups. Prior SBCS participants and small businesses on publicly available email lists are also contacted directly by the Federal Reserve Banks. To control for potential biases associated with the non-random nature of the sample, respondents are weighted so the weighted distribution of firms in the SBCS matches the distribution of the small (1 to 499 employees) firm population in the United States by number of employees, age, industry, geographic location (census division and urban or rural location), gender of owner(s), and race or ethnicity of owner(s).

Figure 1: Percent of firms applying for a loan, line of credit, or cash advance in the prior 12 months, by lender type and firm credit risk

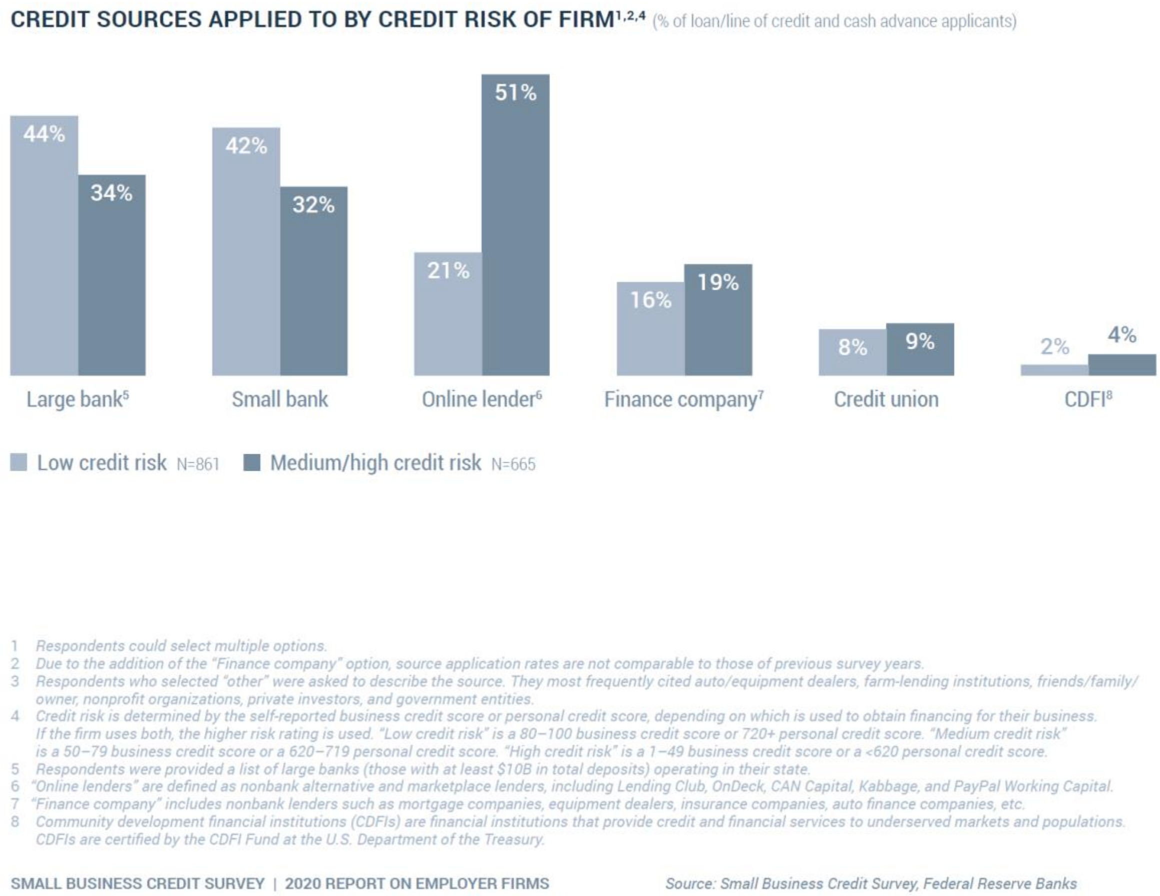
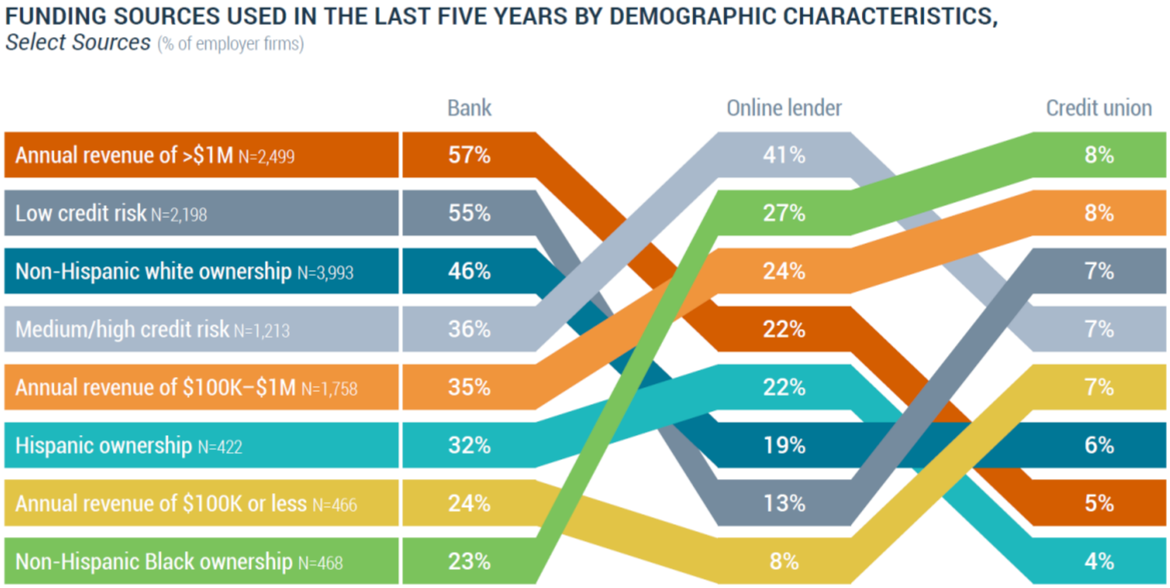


Figure 2 shows percent of survey respondents that report having borrowed in the past five years, by type of lender, with firms separated into eight cohorts based on financial and demographic characteristics. Again, note that some respondents within each risk cohort may have borrowed from more than one type of lender.

Source of financing varies significantly by race and ethnicity of the owner, firm revenue size, and credit risk. Again, the medium/high credit risk small business applicants are associated with comparatively high reliance on online lenders: 41 percent of the firms in this cohort report having borrowed from an online lender, compared to 36 percent that borrowed from a bank. Reliance on online lenders is also comparatively high for non-Hispanic, black-owned firms.

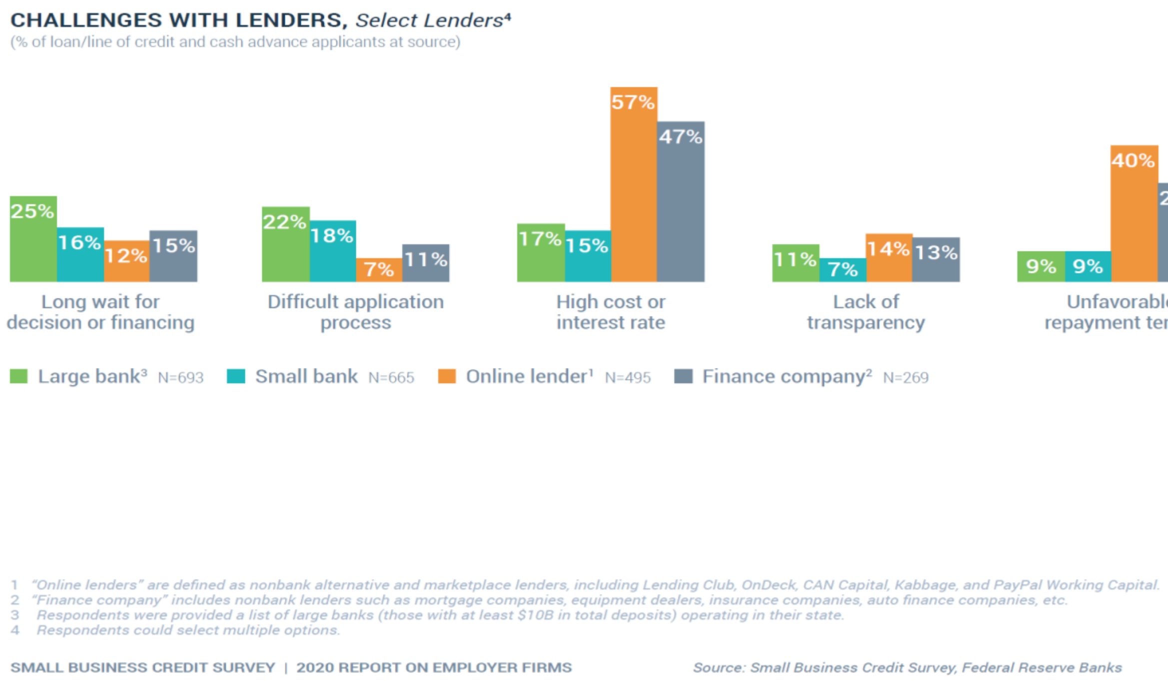
Figure 2: Percent of firms that borrowed in past five years, by type of lender and firm characteristics



The Federal Reserve's report also describes financing challenges faced by many small businesses. Figure 3 shows the percent of survey respondents encountering various types of difficulties when applying for credit during the prior year, again by lender type.

Most prominently, firms borrowing from online lenders and finance companies were dissatisfied with the interest rate or cost of funds and tended to view the financing terms as unfavorable. This raises concerns about potential disparate impacts, to the extent that it may be minority-owned businesses that more frequently encounter such difficulties. These findings further underscore the need for including both banks and nonbanks in the collection of section 1071 data to ensure robust fair lending enforcement in this sector.

Figure 3: Percent of firms that faced difficulties in applying for credit during prior year, by lender type



SUMMATION

Given the important roles of both depository institutions and nonbanks in small business finance, both should be required to submit section 1071 data. Restricting the submission of these data to depository institutions would undermine the important purposes of section 1071—to facilitate the enforcement of fair lending laws, and the identification of business and community development needs and opportunities of women-owned and minority-owned small businesses. Moreover, it would ignore the experience gained under HMDA, in which, over time, Congress and the regulatory agencies recognized that in order to appropriately enforce the fair lending laws with respect to residential mortgage loans, all such lenders – bank and nonbank – had to be covered under HMDA.

The CFPB has repeatedly highlighted fair lending enforcement as a key focus of the Bureau in 2021 and beyond.[25] Limiting data collection to depository institutions would thwart the Bureau's ability to enforce the fair lending laws as effectively as possible. Moreover, requiring only DIs to submit these data will harm competition in the small business lending market due to substantially increased regulatory costs for DIs exclusively.[26]

More generally, for similar reasons, any non-public data collections by the CFPB undertaken in a supervisory context for assessing compliance with fair lending or consumer protection rules, should encompass not just banks but also significant nonbank lenders, including FinTech companies. As described in the CFPB's Supervision and Examination Manual, the agency's examiners and analysts obtain and use data from a wide range of sources,

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[25] *See,* Note 3, *supra*.

[26] Finally, banks and nonbanks should be subject to equivalent exemption standards for section 1071 reporting. The CFPB is considering, in relation to section 1071's statutory purposes, alternative criteria for exempting FIs from any collection and reporting requirements, including size-based and/or activity-based thresholds. To the extent that the CFPB evaluates the burdens of section 1071 reporting requirements, the agency should evaluate the regulatory costs versus the policy benefits in a consistent manner across the small business lending market. In a December 14, 2020 comment letter to the Bureau, BPI indicated a preference for the CFPB taking an activity-based (as opposed to size-based) approach.

including data obtained from lending institutions through monitoring and examination activities.[27] If banks and nonbanks are to be held to the same fair lending and consumer protection standards, as they should be, then a consistent degree of information gathering, including non-public collection of data, must be applied across lender categories.

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[27] See CFPB Supervision and Examination Process Overview, page 4. The CFPB is authorized to collect information in fulfilling its obligation to "monitor for risks to consumers in the offering or provision of consumer financial products or services, including developments in markets for such products." 12 USC 5512(c)(1)(4). The Bureau also may supervise a larger participant in a market for other consumer financial products or services as the Bureau determines via rulemaking. The CFPB should also consider issuing a rule to supervise larger nonbank participants in the market for small business lending.

APPENDIX 1: THE CFPB'S PROGRESS TOWARD DEVELOPING A SECTION 1071 RULE

Steps taken by the CFPB toward developing a proposed rulemaking on section 1071 data include:

- The Bureau held a field hearing on May 10, 2017, and immediately thereafter (on May 15) issued a Request for Information regarding the small business lending market.

- Also in May 2017, the Bureau released a white paper setting forth the findings of the Bureau's research on the small business lending environment, with a particular emphasis on lending to women-owned and minority-owned small businesses.

- In November 2019, the Bureau held a symposium on section 1071 to stimulate a dialogue to assist the Bureau in its policy development process and to receive feedback from experts, including academic, think tank, consumer advocate, industry, and government experts in the small business lending arena.

- On September 15, 2020, the Bureau published alternative proposals under consideration to implement section 1071, and announced that, pursuant to the Small Business Regulatory Enforcement Fairness Act it was convening a panel of stakeholders and experts (Small Business Review Panel) to vet these proposals.

- On December 14, 2020, the Bureau published the Small Business Review Panel's final report on these proposals.

APPENDIX 2: POST-2000 REVISIONS TO HMDA

In 2002, the Federal Reserve Board, exercising its rule-writing authority under HMDA, increased the number of required data items, effective with the 2004 HMDA submissions, including identification of so-called "high-priced" loans (mortgages with annual percentage rates above designated thresholds.)[28] In particular, lenders were required to identify (so-called "high-priced loans.") Other new disclosures included lien status of the loan (whether it is a first or junior lien), whether it is secured by a manufactured home, and whether it is subject to the protections of the Home Ownership and Equity Protection Act of 1994.

Section 1094(3) of the DFA amended HMDA to require institutions to report, among other things, age, application channel (i.e., broker), credit score, loan term, negative amortization, prepayment penalty term, property value, rate spread for all loans, and total origination points and fees. In addition, the DFA granted to the CFPB discretionary authority to require reporting of other new data items or to revise preexisting data items.[29] Subsequently, in 2015 and 2017, the CFPB put forth rules for new and revised data points in accordance with the DFA amendments. These changes were implemented beginning with the 2018 HMDA reporting cycle.

Among the required data items added by the DFA are interest rate spread (for all loans, not just those that are "high cost") and total points and fees, which allow for analysis of loan pricing. Another is applicant credit score, an important factor in a bank's loan origination and pricing decisions. Pursuant to its discretionary authority, the CFPB mandated reporting of two additional, important measures of credit risk: the borrower's debt-to-income ratio and the loan-to-value ratio (or combined loan-to-value ratio when a junior lien is present.)

The CFPB also revised several preexisting data points. Not all of the newly added data items are available in the public release of HMDA data. The CFPB has opted to exclude several of them (including applicant credit score) from the public release of the data, in order to protect the privacy of applicants and borrowers. For a complete listing of added data items, revised data items, and related details see "An Updated Review of the New and Revised Data Points in HMDA," Consumer Financial Protection Bureau, August 2020.

[28] 67 Fed. Reg. 7222 (Feb. 15, 2002).
[29] 12 USC 5481(12)(k), 12 USC 5512 et. seq.